CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Senate Bill 728 **Senator Machado (As amended 1/18/02)**

Position: **No position, note concerns (Staff recommendation)**

Proponents: **California Department of Personnel Administration (Sponsor)**
California State Employee Association (Sponsor)

Opponents: **California State Personnel Board**

SUMMARY

Senate Bill 728, among other things, temporarily reduces employee retirement contribution rates for specified state employees who are members of the Defined Benefit (DB) Program of the California State Teachers' Retirement System (CalSTRS) or the California Public Employees' Retirement System (CalPERS). It also corrects a drafting error contained in previous legislation that eliminated the contributions to Defined Benefit Supplement (DBS) Program accounts of state CalSTRS members during the period of time that DB Program contributions are reduced.

HISTORY

Chapter 365, Statutes of 2001 (AB 906—Salinas) temporarily reduces employee retirement contribution rates for specified state employees who are members of the CalPERS or the DB Program of CalSTRS.

Chapter 74, Statutes of 2000 (AB 1509—Machado) requires that 25 percent of the contributions of members of the DB Program be redirected to a separate nominal account in the DBS Program until January 1, 2011.

CURRENT PRACTICE

Under current law, 28 state employees are members of the DB Program. Existing law prescribes fixed contribution rates for members of the DB Program (including state employees), as well as their employers. Currently, active members contribute an amount equal to 8 percent of their creditable compensation to the DB Program. The member's contribution provides a portion of the funding for DB Program and DBS Program benefits. CalSTRS calculates a member's retirement benefit under the DB Program using (1) the member's credited service, (2) a factor based on the member's age at retirement, and (3) the member's final compensation.

The DBS Program provides supplemental benefits for members of the DB Program. Currently, a quarter of the member's contributions to CalSTRS (currently equal to 2 percent of the member's creditable compensation) are credited to the member's DBS Program account, rather than the member's DB Program account. There is no reduction in the member's DB Program benefit despite the reduction in contributions to that program. Member contributions to the DBS Program from this source began January 1, 2001, and will continue until January 1, 2011. These contributions are credited with interest, and the balance of credits is distributed to the member upon his or her retirement, disability, death or termination, either in a lump sum or as a monthly annuity.

Over the past year, the Department of Personnel (DPA) has negotiated collective bargaining agreements (called a Memorandum of Understanding, MOU) with the 21 state employee Bargaining Units. MOUs require ratification by the Legislature and normally make a number of changes to state law. AB 906 (Salinas) was amended during the final days of the 2001 legislative session to ratify the MOU for Bargaining Units 10, 12, 13, 16, 18, 19 and for state employees who were either exempt from civil service or excluded from collective bargaining. That bill, enacted as Chapter 362, included language that temporarily reduces the employee retirement contribution rates to the DB Program of the affected employees from 8 percent of the member's creditable compensation to 5.5 percent from August 31, 2001 to June 30, 2002, and to 3 percent from July 1, 2002 to June 30, 2003.

While the series of recent MOU agreements affects thousands of state employees who are active CalPERS members, the 28 state employees are active members of the DB Program also are affected by these agreements. There were two "excluded" employees in the California Community College Chancellor's Office eligible under AB 906 for the temporarily reduced employee contribution rates. Of the remainder, the State Board of Education employs 24 members, one member is employed by the Commission on Teacher Credentialing, and one member is employed at a state hospital. Bargaining Units 21 and 3 represent these employees.

As drafted, Chapter 365 also eliminated contributions made by affected state members of the DB Program to their DBS accounts while their DB Program contributions are temporarily reduced. This in turn reduces their future DBS Program benefit. CalSTRS staff determined the impacts of the bill on the DB Program were nominal. Due to the timing of the amendments to that legislation, the Teachers' Retirement Board (Board) did not have an opportunity to take a position on that bill. Moreover, DPA did not inform the CalSTRS that these reduced employee contributions would apply to state CalSTRS members at the time the proposal was being discussed with the bargaining units.

DISCUSSION

SB 728:

- Reduces member contributions to the CalSTRS DB Program to 5.5 percent of the member's creditable compensation from January 1, 2001 to June 30, 2002, and to 3 percent from July 1, 2002 to June 30, 2003, for all members who are state employees in Bargaining Units 1, 3, 4, 11, 15, and 21.

- Provides authority for future MOU agreements to set the contribution rate for state members of the DB Program.

- Corrects a drafting error contained in Chapter 365 that eliminates contributions by state CalSTRS members to their DBS Program accounts.

According to the sponsor, DPA, the package of MOU agreements are designed to increase state employees' current take-home pay without reducing retirement benefits, but delay the impact to the State treasury during a period of decreasing revenues. Under the MOUs, both CalPERS and CalSTRS state employee members will see their respective retirement contribution rates drop by the same amount (2.5 percent initially, then a total of 5 percent).

However, the impact of these reductions on CalSTRS and CalPERS will be different. The CalPERS Board has the authority to set employer contribution rates. As a result, any impact on CalPERS benefit programs from the reduction in employee contributions will be offset by an increase over time in contributions imposed on the state as an employer. Neither CalPERS nor any other CalPERS employer will be affected by the reduction in state employee contributions. The employer contribution rate for CalSTRS, on the other hand, is set in statute; the Board has no authority to change those rates, particularly for individual employers. As a result, although the impact of this temporarily reduced state employee contribution rate on the DB Program will be nominal, it is an impact that will be borne by the DB Program as a whole. Similarly, one set of CalSTRS members, specifically state employees, will be contributing less to the DB Program than will other CalSTRS members, even though the benefits both groups of members are eligible for are the same.

It should also be noted that even though applying this proposed reduction in contribution rates to both CalSTRS and CalPERS members appears to treat all state employees the same, in fact it does not. Members of Tier II of CalPERS pay no employee contributions for their CalPERS benefit, in return for a lower benefit program. As a result, these state CalPERS members will not benefit at all by the reduction in employee contribution rates.

A drafting oversight in the chaptered version of AB 906 prevents affected state employees' contributions from being credited to their DBS accounts for the period their DB Program contributions are reduced, thereby decreasing their future DBS Program benefit. Because (1) it was not the intent of the sponsor to deny benefits to state employees under either the CalSTRS or CalPERS retirement programs, and (2) the administrative cost associated with eliminating the DBS Program contributions for these employees would likely exceed the program cost to CalSTRS of continuing the contributions, CalSTRS staff prepared language, now contained in SB 728, that credits 25 percent of affected members' reduced contributions to the DB Program to their DBS accounts. For affected state employees, the amount credited to the DBS Program will equal 1.37 percent of creditable compensation in the first year of the contract and .75 percent in the second year. These members will have less money credited to their DBS account, and therefore will receive less money available at the termination of employment because 25 percent their reduced contributions to CalSTRS are credited to their DBS account, rather than a full 2 percent of creditable compensation made by other members.

FISCAL IMPACT

Benefit Program Costs – Given the small number of affected members, the System Actuary has determined the reduced contributions to the DB Program by the 28 affected state employees would not have a material effect on the DB Program.

Administrative Costs – Undetermined, likely nominal costs associated with adjusting reporting procedures, manually receiving employee and employer contributions, and inputting corrected data into CalSTRS' automated systems.

RECOMMENDATION

No position on provisions concerning the reduction in the DB Program contribution rate for state members. However, although the fiscal impact of the reduced contributions on the DB Program is nominal, the proposal benefits a small group of individuals within a larger group, without correcting an inequity that currently exists in legislation. The proposal creates a division between CalSTRS members who are not state employees and state employees covered by the DB Program, by temporarily providing a different contribution rate for different members in the same benefit program.